

TESTIMONY BY KALBERT K. YOUNG
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON FINANCE
ON
HOUSE BILL NO. 504

February 14, 2013

RELATING TO STATE FUNDS

House Bill No. 504 amends the criteria to establish new special or revolving funds to clarify that a special or revolving fund to be established or continued shall reflect a clear nexus between the benefits sought and charges made upon the program users or beneficiaries or between the program and the sources of revenue. This bill also requires the auditor to review special funds, in addition to revolving and trust funds, every five years based on specified departmental groupings.

The Department of Budget and Finance supports this bill and its intent to provide more specific criteria for the establishment of new special and revolving funds and the continuance of existing special and revolving funds. Because special, revolving and trust funds should only be used for their specified purpose and cannot be used for other programs, we must continue to ensure that these funds are the most appropriate funding mechanism for the programs which they support.

**TESTIMONY OF JAN K. YAMANE, ACTING STATE AUDITOR,
ON HOUSE BILL NO. 504, RELATING TO STATE FUNDS**

**House Committee on Finance
February 14, 2013**

Chair Luke and Members of the Committee:

I am Jan Yamane, Acting State Auditor. Thank you for this opportunity to testify in support of House Bill No. 504 (HB 504), which implements our recommendations in our July 2012 Report No. 12-04, *Study of the Transfer of Non-general Funds to the General Fund*, requested by the 2011 Legislature in House Concurrent Resolution No. 166, by:

- 1) Amending Section 23-11, HRS, to require evidence of need for evaluating new special and revolving funds;
- 2) Amending Section 23-12, HRS, to institute regular reviews of special funds, and include the Departments of Transportation and of Defense in regular reviews of revolving and trust funds;
- 3) Amending Sections 37-52.3(2) and 37-52.4(2), HRS, to establish the clear nexus criterion for the establishment and continuance of special and revolving funds and Section 37-62, HRS, to clarify the definitions of special and revolving funds, and
- 4) Repealing funds that fail to meet criteria for continuance.

First, Section 23-11 requires my office to analyze new special and revolving funds proposed in each regular session to ensure the fiscal integrity of the State. Over the years, we have noted that the criteria for analyzing new funds are limited. Thus, we recommend requiring evidence of need before establishing new special and revolving funds. Section 2 of this bill addresses this by establishing that the evidence of need should: state the program's purpose; describe the scope; present financial information on fees to be charged, sources of projected revenue, and costs; and explain why the program cannot be implemented successfully under the general fund appropriation process. We believe application of these criteria will result in more effective analysis of each new fund and, hence, better information for your legislative decision-making.

Second, Section 3 of this bill adds review of special funds to existing reviews of trust and revolving funds conducted by my office on a five-year rotational basis. We have conducted reviews of trust and revolving funds since the enactment of Act 240, Session Laws of Hawai'i 1990. With these reviews, the Legislature has been able to monitor whether revolving and trust funds meet criteria for continuance; however, no mechanism exists for periodic reviews of special funds. For example, we conducted evaluations of special funds in 1991, 1992, and 2001, making our 2012 evaluation of special funds in Report No. 12-04 the first in ten years.

Currently, 186 special funds are not subject to periodic review and in FY2011 comprised 24.3 percent (\$2.48 billion) of the State's \$10.2 billion operating budget. And while special funds account for a significant portion of the State's operating budget, the moneys are not subject to the same level of legislative scrutiny as general funds. Requiring period reviews of existing special funds would be fiscally prudent, especially since our most recent evaluation of funds determined that five special funds did not meet criteria for continuance.

Third, Sections 4 and 5 amend the law to clarify criterion for the establishment and continuance of special and revolving funds that is intended to safeguard against overproliferation and inefficiencies. Designating revenue for specific purposes flows from the *benefit theory* of public finance, which postulates that those who benefit from a program should pay for it. The *clear nexus* requirement is arguably drawn from this theory. Adhering to the benefit theory can result in an efficient allocation of services in which the cost of providing a service is reflected in the charges made to users or beneficiaries. However, there are instances in which the revenue source is related to the program activities, such as in the case of regulatory fines, but program beneficiaries or users do not pay. Based on our analysis of nine special funds, we concluded it would be reasonable for the Legislature to continue funds that fail to meet the clear nexus criterion in situations where there are linkages between the programs and the sources of revenue dedicated to their support. Both bills accomplish this by clarifying the criteria for and definitions of special and revolving funds under Sections 37-52.3(2), 37-52.4(2), and 37-62, HRS.

We note, however, that this bill stops short of implementing our final recommendation to eliminate the following funds for failing to meet criteria for continuance:

- **Driver Education Fund**, Department of Education, does not have a clear link with funding from the fees paid by insurers on each insured motor vehicle.
- **Emergency Medical Services Special Fund**, Department of Health, is used for the state's comprehensive emergency medical services but there is no clear link with its main funding sources, which consist of a portion of vehicle registration fees and tobacco taxes.

- **Mental Health and Substance Abuse Special Fund**, Department of Health, supports a program that provides broad population-wide benefits and that draws most of its funding from the general fund; hence, we maintain all of its funding should come from the general fund.
- **Land Conservation Fund**, Department of Land and Natural Resources, is funded from 10 percent of state real property conveyance tax receipts, but beneficiaries are state residents as a whole, not just individuals and companies who pay conveyance taxes.
- **Natural Area Reserve Fund**, Department of Land and Natural Resources, provides broad benefits but a narrow funding base from the conveyance tax paid on real estate transactions.
- **Research and Training Revolving Fund**, University of Hawai‘i, supports research and training activities and has sources of revenue in federal and non-federal reimbursements for indirect facilities and administrative costs. The fund does not have a clear link between benefit sought and charges made upon beneficiaries because there are not user fees or charges on the researchers.

To fully implement our report recommendations, we ask that you consider amending this measure to repeal these funds.

Thank you for the opportunity to testify in support of HB 504. I will be happy to answer any questions you may have.

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TAX FOUNDATION OF HAWAII

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SUBJECT: MISCELLANEOUS, Review of special or revolving funds

BILL NUMBER: HB 504

INTRODUCED BY: Jordan, Cabanilla, Hanohano, Ichiyama, Ing, Ito, Oshiro, Say, and Yamashita

BRIEF SUMMARY: Amends HRS section 23-11 to amend the criteria used by the auditor in analyzing legislative bill containing new special or revolving funds to: (1) include evidence of need by stating the program's purpose, describing the scope, presenting financial information on fees to be charged, sources of projected revenue and costs, with an explanation why the program cannot be implemented successfully under the general fund appropriation process; and (2) that the fund reflects a clear link between the benefits sought and charges made on the program users or beneficiaries or a clear link between the program and the sources of revenue, as opposed to serving primarily as a means to provide the program or users with an automatic means of support that is removed from the normal budget and appropriation process.

Amends HRS section 23-12 to provide that special funds shall be included in the auditor's review of revolving and trust funds of the state and beginning 2014 and every five years thereafter, the auditor shall submit a review of the special, revolving, and trust funds of the department of transportation and the department of defense.

Amends the definition of "revolving fund" and "special fund" to add "provided that the funds are used only when the means of financing is essential to the successful operation of a program or activity and there is a clear link between the program or activity and the sources of revenue dedicated to its support."

Makes conforming amendments to HRS sections 37-52.3 and 37-52.4.

EFFECTIVE DATE: June 30, 2013

STAFF COMMENTS: Under the existing law the state auditor is required to review the revolving and trust funds of the state and submit a report to the legislature. It should be remembered that the 1990 legislature by Act 240 required the auditor to conduct a review of all special and revolving funds and submit recommendations as to whether they should be continued, modified or repealed. While the completed reviews were submitted in 1991 and 1992, an update done in July 2001 revealed that 71 special and revolving funds had been repealed or discontinued. The auditor later found that 106 out of 166 of the special funds they reviewed were still being utilized as of July 1, 1999.

Over the last 15 years, more and more of the state's operating budget has been underwritten by special funds, many of which were created during that same time period. These are other than the three special funds established long before statehood for the transportation programs of the state. For example 11.7% of the 1995-1997 biennial budget appropriated by the legislature was financed from special funds other

than the transportation special funds. That portion grew to more than 17.3% as of the 2007-2009 biennial budget. As a result, when those programs were moved to earmarked funding status, they freed-up more general funds that were used to finance those programs allowing lawmakers to fund brand-new programs that probably would not have been funded in the past. Not only did this process obscure the growth and size of state government, but it also allowed lawmakers to escape the governance of the constitutional general fund expenditure ceiling as this mechanism does not indicate a growth in the size of state general fund spending. Bringing both those favored programs and their earmarked sources of funding back on to the general fund table will give lawmakers and taxpayers a better idea of the size of government.

While this measure proposes that special funds shall also be reviewed by the auditor, it should be noted that while HRS section 37-47 requires each state department to report on each of their non-general fund accounts to the legislature annually, these reports just contain information on the financial condition of each account. However, these reports are incomplete or lack the detail that would otherwise reveal the mismanagement and potential fraud that had or could occur. Such is the case with the state's beverage deposit fund which the Auditor, as well as a third party observer, found to be rife with inaccuracies and missing information.

While this measure would allow the auditor to continuously review the special funds, it may also reveal the number of new special funds added each year by the legislature and bring to light how much money is hidden in these special funds. Lawmakers may consider adding another provision requesting that the Auditor also total the amount of money being spent through these special funds not meeting the criteria and present that number, in the aggregate, to give lawmakers a better idea of how much it would cost if they were required to be funded through the general fund. Once totaled, how that number, together with funds appropriated from the general fund in that respective year, could be measured up against the constitutional general fund ceiling for the respective year. This would give lawmakers and the taxpaying public a better idea of whether or not state government has kept up with the growth in the state's economy or exceeded it. Currently, because these special funds obscure the overall cost of government, taxpayers - as well as lawmakers - have no clue as to the true size of government.

Digested 2/12/13



HPCA

HAWAII PRIMARY CARE ASSOCIATION

House Committee Finance

The Hon. Sylvia Luke, Chair

The Hon. Scott Y. Nishimoto, Vice Chair

The Hon. Aaron Ling Johanson, Vice Chair

Testimony on House Bill 504

Relating to State Funds

Submitted by Robert Hirokawa, Chief Executive Officer

February 14, 2013, 3:30 PM, Room 3081

The Hawai'i Primary Care Association, which represents fourteen community health centers in Hawai'i, **has concerns** about House Bill 504, Relating to State Funds.

The Hawaii Primary Care Association understands and supports the efficient use of government funds. As a non-profit entity, we fully believe in and comply with all regulations that are required for public funding. However, the HPCA has critical concerns about the proposed language changes in House Bill 504.

New language calls for “a clear link between the benefits sought [by a special fund] and charges made upon the program users or beneficiaries or a clear link between the program and the sources of revenue...” This is troubling for community health centers, which receive funding to provide health care to uninsured individuals and families through the community health center special fund in the Department of Health. The community health center special fund's only source of revenue is a dedicated portion of cigarette tax revenues. Prior to the creation of the special fund, funding for the uninsured's health care was provided through a general fund line item in the Department of Health's budget. While our intent in advocating for the creation of our special fund was to provide dedicated funding to expand capacity and infrastructure at community health centers, the State made the decision to use the special fund monies to supplant our general fund line item; thus eliminating the line item funding for health care for the uninsured and replacing it with the special fund monies. We welcome the consideration of the legislature to restore funding to community health centers in the Department of Health's budget. However we cannot support a measure that threatens to eliminate our sole source of funding health care for Hawaii's uninsured. Monies in the community health center special fund are only used for the purpose of funding direct health care needs for the uninsured at Hawaii's fourteen health centers.

Please protect funding for Hawaii's community health centers and the underserved, uninsured, low-income populations that we serve. We urge you to take these concerns into consideration and make appropriate amendments. Thank you for the opportunity to testify.

Written Statement of
YUKA NAGASHIMA
Executive Director & CEO
High Technology Development Corporation
before the
HOUSE COMMITTEE ON FINANCE
Thursday, February 14, 2013
3:30 p.m.
State Capitol, Conference Room 308
In consideration of

HB 504 RELATING TO STATE FUNDS.

Chair Luke, Vice Chair Nishimoto, and Members of the Committee on Finance.

The High Technology Development Corporation (HTDC) respectfully **offers comments** on HB 504 which requires an audit on special and revolving funds every five years. HTDC offers comments broken out by section:

SECTION 3. Section 23-12(b)(2):

The insertion of special funds in this section as it reads would require a review of the special fund beginning 1995 and every 5 years thereafter. This may require the auditor to do a retroactive review of special funds going back to 1995 to comply with the statute. This is unnecessary and not practicable. We suggest that clarifying language be included to state that special funds will be subject to review effective from enactment of this addition (such as beginning 2013) and every 5 years thereafter.

SECTION 4. Section 37-52.3 (2):

The statute will read, "Reflects a clear nexus between the benefits sought and charges made upon the ~~[users or beneficiaries of the program,]~~ program users or beneficiaries, or a clear link between the program and the sources of revenues, as opposed to serving primarily as a means to provide the program or users with an automatic means of support that is removed from the normal budget and appropriation process".

Past history has indicated that Department(s)/agencies tasked with implementing provisions of an updated statute tends to be conservative in interpreting the intention of the language inserted into bills and then narrowly define the intent. There is the potential that "a clear link between the program and the sources of revenue" is to be interpreted to mean that the source of the revenues must be solely expended on the project generating the revenues. An example is revenues generated by HTDC's incubation technology centers can only be expended for the technology centers program expenses and activities. This narrow interpretation would be too restrictive for HTDC's purposes.

206M-15.5, High Technology Special Fund allows funds deposited into its special fund to be used for all activities of the agency. In past hard fiscal times, the Legislature reduced HTDC's

general fund appropriation directing HTDC to become more reliant upon the revenues deposited into the special fund to fulfill all aspects of its mission. A narrow interpretation of 37- 52.3 (2) by the responsible department/agency without knowledge of the past direction given to HTDC could potentially limit the types of expenses being funded by the special fund and jeopardize the agency's ability to meet its financial obligations.

Thank you for the opportunity to submit testimony on this bill.